

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2017-228-S

IN RE:)	
)	
Application of Palmetto Utilities, Inc.)	<u>PREFILED REBUTTAL</u>
for adjustment of rates and charges)	<u>TESTIMONY OF</u>
for, and modification to certain terms)	<u>MARK S. DADAY</u>
and conditions related to,)	<u>ON BEHALF OF PALMETTO</u>
<u>the provision of sewer service.</u>)	<u>UTILITIES, INC.</u>

1 **Q. ARE YOU THE SAME MARK S. DADAY THAT HAS PREFILED DIRECT**
2 **TESTIMONY IN THIS CASE?**

3 A. Yes, I am.

4 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**
5 **PROCEEDING?**

6 A. The purpose of my rebuttal testimony is to respond to portions of the pre-filed direct
7 testimony of ORS witnesses Aisha L. Butler, Willie J. Morgan, P.E., and Michael L.
8 Seaman-Huynh.

9 **Q. DOES PALMETTO AGREE WITH ORS’S ADJUSTMENT TO DISALLOW ALL**
10 **PLANT ASSOCIATED WITH THE COLLECTION AND TRANSPORTATION**
11 **SYSTEM FOR THE FORMER PRC SERVICE AREA PLACED INTO SERVICE**
12 **PRIOR TO MARCH 2013?**

1 A. No, it does not. However, Palmetto and ORS have reached a stipulation that this
2 issue can be addressed in a future rate proceeding without precluding either party from
3 taking a position regarding the valuation of this plant for ratemaking purposes. Therefore,
4 the Commission does not need to resolve our differences on this point in this proceeding.

5 **Q. WHAT IS YOUR UNDERSTANDING OF ORS'S POSITION WITH RESPECT TO**
6 **PALMETTO'S PROPOSAL TO REDUCE THE \$2,640 PER SINGLE FAMILY**
7 **EQUIVALENT PLANT EXPANSION FEE, THE \$300 CONNECTION FEE, AND**
8 **THE \$30 PER CUSTOMER ACCOUNT SET UP CHARGE CURRENTLY**
9 **APPLICABLE TO CUSTOMERS IN THE FORMER PRC SERVICE AREA TO**
10 **THE AMOUNTS PREVIOUSLY APPROVED BY THE COMMISSION FOR**
11 **CUSTOMERS IN THE ORIGINAL PALMETTO SERVICE AREA?**

12 A. It is Palmetto's understanding that ORS now opposes that proposal. I should note
13 that ORS incorrectly asserts that the pertinent connection fee amount is \$1,300 and not
14 \$300. I will address that later in my rebuttal testimony.

15 **Q. WHY DO YOU SAY THAT ORS "NOW" OPPOSES THAT PROPOSAL?**

16 A. I say that for two reasons.

17 First, ORS has accepted Palmetto's current \$800 plant impact fee, \$250 connection
18 charge, and \$20 customer account charge as being cost based in both of the prior rate cases
19 submitted by Palmetto since ORS came into existence. To suggest now that it is not cost-
20 justified for a portion of Palmetto's service area is a change from ORS's prior positions
21 before this Commission. Additionally, ORS accepted the pro forma adjustment for the
22 \$250 connection fee which is detailed in Exhibit MSH-3 for Miscellaneous Revenue.

1 Second, ORS recognized that Palmetto's application requested that the
2 Commission accept the application for filing without cost justifications for these reductions
3 in non-recurring charges by seeking a waiver of Commission Rule 103-512.4(9) as
4 permitted by Commission Rules 103-501 and 103-803. However, ORS did not challenge
5 this request for a waiver and the application has been accepted for filing by the
6 Commission. If ORS felt that the Commission should have rejected the application
7 because it did not comport with Rule 103-512.4(9), it should have filed a motion in
8 opposition to that request with the Commission before the Commission accepted the
9 application for filing. But it did not do so.

10 **Q. SHOULD THE COMMISSION ADOPT ORS'S NEW POSITION REGARDING**
11 **THESE NON-RECURRING CHARGES WHICH APPLY ONLY TO FUTURE**
12 **CUSTOMERS IN THE FORMER PRC TERRITORY?**

13 A. No, it should not for a number of reasons.

14 Initially, I would note that ORS does not assert that the current non-recurring
15 charges for customers in the PRC portion of the service territory are themselves cost
16 justified. Nor can it as the South Carolina Supreme Court in 2015 made clear that the rates
17 and charges imposed by the City of Columbia for sewer service – which have been in effect
18 since at least 2013 -- are not cost-based because the City routinely diverted funds from its
19 utility operations to general fund projects. Thus, there is no factual basis to support ORS's
20 apparent assumption that these three non-recurring charges are themselves cost-justified.
21 In fact, the application of the \$2,640 plant expansion fee to the 12,730 ERCs which ORS
22 has determined are served in the former PRC territory would have generated \$33.6 Million

1 – approximately \$15.6 Million more than PRC paid the City for the collection and
2 transportation system.

3 I would further note that Palmetto's \$800 plant impact fee, consistent with
4 Commission Rule 103-502.10, is designed to recover only a portion of the cost of capacity
5 consumed by a new customer tapping on to the Palmetto system. ORS has not asserted
6 that this charge is not cost-justified or recommended that the existing plant impact fee
7 should be increased for other customers and this fact should weigh heavily in the
8 Commission's analysis of this issue. That this \$800 charge is more cost-justified than that
9 currently applied to customers in the former PRC service areas is also amply illustrated by
10 the fact \$33.6 Million dollars would have been generated by the City's \$2,640 plant
11 expansion fee – approximately 186% of the price Palmetto paid for the collection and
12 transportation system that was purchased from the City. On the other hand, approximately
13 \$10.2 Million would have been generated by the plant expansion fee if it had been applied
14 to the former PRC customers. Palmetto submits that a plant expansion fee of \$2,640 covers
15 far in excess of a portion of the cost of capacity in the former PRC plant while a plant
16 impact fee of \$800 would have covered a reasonable portion of the cost of capacity as
17 measured against the purchase price for that plant net of depreciation.

18 In addition to the foregoing, I would note that there are a large number of
19 jurisdictional sewer utilities with much lower plant impact fees than Palmetto's \$800
20 charge which ORS has not proposed be increased in any recent sewer rate relief
21 proceedings. To the contrary, in the last seven sewer rate relief proceedings which ORS
22 participated in as a party of record, I cannot find an instance where it proposed that any
23 existing plant impact fee or similar charge be increased. I think this reflects ORS's prior

1 recognition that the amount of plant impact fees does have an impact on economic
2 development. Although that factor is mentioned in Mr. Seaman-Huynh's testimony, I
3 would suggest that ORS is not giving it sufficient consideration in this instance.

4 Another consideration is that the new ORS position would prevent the merger of
5 PRC into Palmetto from being a true merger, which is to say that the non-recurring charges
6 would not be uniform among the customer base and additional cost will be incurred in the
7 time and effort required to administer different non-recurring charges for different
8 customers.

9 Finally, ORS's position that the proposed plant impact fee may cause a "cost
10 shift which impacts the Company's existing customers" even if correct, fails to take into
11 account the benefits that customers in the former PRC service area have received from
12 being PRC customers. Specifically, these customers were shielded from three separate rate
13 increases by the City of Columbia which would have had their current average residential
14 monthly sewer service charge at \$60.75. In addition, these customers received the benefit
15 of cost savings and efficiencies associated with the merger of PRC into Palmetto. Clearly,
16 customers also benefit when there are more customers connected to the system as it allows
17 costs to be spread across a larger customer base. And, ORS's position assumes that only
18 new customers in the PRC portion of the service area benefit from the additions to plant
19 which PUI has made. This is demonstrably incorrect as these plant additions take flow
20 from the customers, transport it to the Spears Creek Regional WWTP for treatment, and
21 dispose of it in the Wateree River.

22 **Q. YOU MENTIONED THAT ORS IS ASSERTING THAT PALMETTO IS**
23 **PROPOSING TO REDUCE THE CONNECTION COMPONENT OF ITS NON-**

1 **RECURRING CHARGES FROM \$1,300 TO \$250 AND THAT YOU DISAGREE**
2 **WITH THAT ASSERTION; WOULD YOU PLEASE ELABORATE?**

3 A. Yes. Mr. Seaman-Huynh's testimony assumes that PUI collects \$1,300 for a
4 connection charge for a new customer in the former PRC service area. However, that
5 \$1,300 fee is chargeable only where PUI makes the connection. In the test year, 188
6 connection fees were received from customers in the former PRC service area and PUI
7 collected \$552,720 in connection and plant impact fees. This amount was reduced to
8 \$47,000 (188 x \$250) in a pro forma adjustment which was left unchanged by ORS in Mr.
9 Seaman-Huynh's Exhibit MSH-3. So, it is clear that ORS recognizes that PUI is not
10 collecting \$1,300 for connection of customers in the PRC service area.

11 **Q. ARE THERE OTHER ADJUSTMENTS PROPOSED BY ORS THAT PALMETTO**
12 **OPPOSES?**

13 A. Yes. Palmetto opposes the following adjustments recommended by ORS:

14 1. Sludge Disposal -- ORS proposed adjustment 3C for sludge reflects updated
15 sludge disposal costs related to the new Palmetto wastewater treatment plant of \$1,614 and
16 was calculated based on invoices for the twelve-month period ending October 31, 2017.
17 Because this included only one month's worth of this expense associated with the new
18 plant, and because the new plant was in a transition period regarding its sludge storage
19 tanks meaning empty tanks were being "charged" with new sludge resulting in temporarily
20 reduced disposal expenses, Palmetto believes a conservative calculation of sludge disposal
21 costs going forward is appropriate. Since sludge is created by removing impurities from
22 incoming water, the amount of sludge created is directly proportional to the incoming flow,

1 since the new plant removes at least as much mass of impurities per unit volume as the
2 previous plant. The additional sludge expense listed in the rate case of \$159,929 was based
3 on a pro-rata calculation based on gallons to be treated and historic cost. It represents a
4 64% increase, which corresponds to the 64% increase in flow resulting from adding PRC
5 flow to the new plant. Less the amount ORS allowed of \$1,614 referenced above, the
6 amount of incremental cost is \$158,315. The disposal of sludge does not decrease because
7 of any plant efficiencies. The biological quality may improve somewhat, but this is
8 irrelevant for disposal costs. Palmetto proposes to reduce the cost of 156,701 (which
9 represents a 64% increase) to a 50% increase of \$133,274, to ensure the cost being borne
10 by ratepayers is no more than (and will actually be less than) the actual cost. Palmetto
11 submits that ORS adjustment 3C should not be accepted, since it clearly does not represent
12 the physical and economic reality that these costs will be incurred, and that the Commission
13 should accept Palmetto's proposed alternative of \$133,274 as a conservative estimate of
14 those actual costs.

15 2. Purchased Power – ORS's proposed adjustment of \$113,470 for purchased
16 power (3D) is based on electric invoices ending October 11, 2017 through October 19,
17 2017, which do not include a full month of updated plant expenses. Although Palmetto
18 believes this expense will continue to increase once the plant digester is at full capacity and
19 the belt press must be operated for additional shifts, Palmetto proposes to apply ORS's
20 method of calculation to the most recent available electric invoices ending November 11,
21 2017, through December 19, 2017, removing the same charges ORS has deemed
22 nonallowable, allocable, or associated with non-business related addresses. Annualizing
23 an average of these invoices, which are a better but not complete representation of new lift

1 station and plant expense, results in allowable expenses of \$1,058,303, which is a \$290,026
2 increase from the book amount of \$768,277. PUI therefore proposes that the ORS
3 adjustment 3D not be accepted and instead be replaced with an adjustment in the amount
4 of \$290,026, which is \$176,557 higher than ORS's proposed adjustment.

5 3. Contract Operator Management Fees -- Palmetto proposes to add \$41,347 in
6 management fees for its contract operator, ESG. ORS disallowed this expense because no
7 signed contract had been made available to it as none was available at that time. An
8 amendment to the contract has now been negotiated and executed by both parties and
9 provided to ORS. In addition, Palmetto proposes to add \$42,000 which is the cost
10 associated with an additional belt press operator necessitated by the increase in sludge
11 resulting from the new treatment process now being utilized. This position will be required
12 when the new plant's sludge handling system has been fully charged and is in steady-state
13 operation, which will occur in February 2018. Palmetto submits that these amounts are
14 reasonable and should be added to its expenses.

15 4. Rate Case Expense -- Palmetto proposes to add \$49,088 to rate case expense to
16 reflect fees and expenses incurred after the ORS cut-off date of November 16, 2017, (for
17 which supporting documentation has been provided to ORS) and that the amortization
18 period be reduced from the five years proposed by ORS to three years. Historically, a three
19 year amortization period has been accepted by ORS for Palmetto and approved by the
20 Commission. In addition, Palmetto will update rate case expense through the date of
21 hearing in this matter.

22 5. Corporate Overhead, capitalized labor, salaries, related property records
23 accounting -- ORS's adjustment 3L makes adjustments to a number of expense items. In

1 the Proforma Plant Depreciation Schedule, ORS calculated non-allowable capitalized labor
2 of \$125,078 related to the salaries of the Senior Vice President of Capital Projects, the Vice
3 President of Engineering, and four Field Technicians located in the South Carolina office.
4 Palmetto disagrees with this adjustment and submits that these expense items should be
5 allocated to Palmetto based on total South Carolina equivalent residential connections, or
6 “ERCs”, at a rate of 80.17%, resulting in additional overhead expense for Palmetto of
7 \$100,192. In addition, the Tap Fee Coordinator position cost of \$49,924 is proposed by
8 ORS to be allocated across Palmetto and Palmetto Wastewater Reclamation, or “PWR,”
9 which is a separate jurisdictional sewer utility under common ownership and control with
10 Palmetto. The Tap Fee Coordinator, however, is only utilized in the Palmetto service area
11 to coordinate with developers and keep track of inspections. As the PWR system is more
12 mature and already developed, with flat growth, it does not require a Tap Fee Coordinator.
13 There has been 1 tap fee collected at PWR in the last two years, which does not support
14 19.9% of the expense as ORS’s adjustment provides. Based on the foregoing, Palmetto
15 submits that additional overhead expense of \$9,933 be allowed for a total addition of
16 \$110,125 in adjustment 3L. In addition, amounts associated with third party invoices
17 submitted from Tangibl Group, Inc., for property records accounting work related to the
18 test year were not allowed on the basis of insufficient detail. These invoices totaling
19 \$37,500 are being submitted to the ORS with the proper detail. After allocation to
20 Palmetto, this increases expenses by \$27,065.

21 6. Property Tax -- The ORS proposed property tax adjustment 5B of \$1,768,474
22 was based on calculating the assessable value of net plant less *gross* contribution in aid of
23 construction (“CIAC”). This adjustment did not consider accumulated amortization of

1 CIAC, which is the appropriate method. Updating ORS's calculation to correct this error
2 yields an increase in Palmetto property taxes of \$758,307. Palmetto proposes that ORS's
3 Adjustment 5B not be accepted and instead a total of \$2,524,569 be recognized in property
4 tax. This assumes that Palmetto will be permitted to address property tax on the PRC plant
5 which ORS has not recognized in a future proceeding per the parties' stipulation.

6 7. Deferred Expense for City Wastewater Treatment – ORS has recognized a
7 portion of the additional amounts paid by Palmetto for wastewater treatment by the City of
8 Columbia and accumulated as a regulatory asset pursuant to Commission Order No. 2016-
9 605 in Docket No. 2016-255-S. However, Palmetto disagrees with the calculation of ORS
10 Adjustment 3A for Amortization of deferred City of Columbia wastewater treatment costs
11 for two reasons. First, ORS recalculates the base wastewater treatment costs billed by the
12 City of Columbia to incorporate a higher number of customers than the City actually billed.
13 The City billed Palmetto \$7.50 per customer times approximately 10,303 customers for a
14 total cost of \$77,271.50 per month. ORS assumes the number of customers should have
15 been 11,370, times the \$7.50 per customer, for a total cost of \$85,275.00 per month. The
16 problem with this recalculation is that the City did not bill this amount and it therefore
17 should not be used to calculate this deferral. It billed the lower amount of \$77,271.50.
18 Using the \$85,275.00 improperly lowers the amount of the deferred City of Columbia
19 wastewater treatment costs being asked for recovery. The \$77,271.50 was correctly used
20 in Palmetto's cost of service.

21 Second, the ORS adjustment did not include all of the City's invoices to Palmetto.
22 The City was slow to bill Palmetto for wastewater treatment and the last three bills for this
23 service (a total of \$653,811.60) were excluded from the total. These bills have since been

1 provided to ORS and Palmetto believes they should be included in determining the seven
2 year amortization of this cost. With these latest bills included and correcting for the
3 adjustment of the base wastewater treatment cost noted above, the total deferred City of
4 Columbia wastewater treatment costs are \$4,055,660.62. The amortization of this cost over
5 the seven year period would be \$579,380.09, an increase of \$76,108.09 to ORS's
6 Adjustment 3A of \$503,272.

7 8. Non-recognition of Extraordinary Retirement Allowance – ORS has not
8 recognized in plant \$417,182, less \$6,835 of accumulated depreciation, for the Palmetto
9 Crabapple Lane project and adjoining land acquisition. The Crabapple Lane project
10 involved the installation of a drainage system for seepage coming from the RIBs beneath
11 Crabapple Lane, a dirt road maintained by Kershaw County, and the use of the adjoining
12 land to receive and naturally disperse of this seepage. This work was required as a result
13 of complaints by Kershaw County to DHEC and was performed with DHEC's approval.
14 Because the RIBs have been taken offline as a result of the installation of the new discharge
15 outfall line to the Wateree River, ORS has eliminated \$136,106 in associated operating
16 expenses. However, ORS has not in turn recognized the extraordinary retirement of this
17 plant consisting of the drainage structure installed by PUI beneath Crabapple Lane and the
18 adjacent land. The Company should be allowed a concomitant extraordinary retirement
19 allowance of \$410,347, same to be amortized over a five year period. This would add
20 \$82,069 to expenses.

21 9. Interest synchronization – An adjustment to synchronize interest expense with
22 rate base is not warranted in an operating margin case as there is no capital structure nor
23 return on rate base involved in this rate-making methodology. In the testimony of ORS

1 witness Butler, she states that interest synchronization is consistent with prior Commission
2 treatment of the issue. However, this statement fails to acknowledge that the Commission
3 has previously been reversed on appeal for applying this treatment to Palmetto. In 2001,
4 the Court of Common Pleas for the Fifth Judicial Circuit reversed the Commission for
5 applying this treatment to Palmetto in its Civil Action No. 00-CP-40-3888. Further, even
6 assuming the treatment proposed by ORS had merit, in order to make its interest
7 synchronization adjustment ORS has assumed a capital structure based on assumed asset
8 values. However, the borrowing for Palmetto is based on a multiple of earnings before
9 interest, taxes, depreciation, and amortization, or "EBITDA," not asset values. Therefore,
10 this is clearly not an asset-based loan. Our financing is based on a short term, low interest
11 rate instead of the imputed higher cost long-term interest rate, about 6.75%, that is more
12 consistent with our long-term life assets that we own. This low interest rate benefits our
13 customers. Our actual interest expense of \$2,145,274 should be recognized.

14 **Q. ORS HAS RECOMMENDED AN OPERATING MARGIN IN A RANGE OF 10%**
15 **TO 15% FOR PALMETTO AS BEING FAIR, REASONABLE, AND BALANCING**
16 **THE PUBLIC INTEREST; WOULD YOU COMMENT UPON THAT**
17 **RECOMMENDATION?**

18 A. I cannot agree with ORS, primarily because operating margin is simply the result
19 of the various accounting adjustments that determine total income for return and total
20 operating revenue. In and of itself, an operating margin does not guide the Commission
21 with respect to the reasonableness of proposed rates. Thus, I do not believe that a
22 recommendation in this regard by ORS is of real analytical value. This can be seen from
23 the fact that the Commission has approved a wide variety of rates for sewer utilities, some

1 of which have generated higher operating margins but at lower rates than now requested
2 by Palmetto. The most obvious example of this is in Palmetto's last rate case, where the
3 Commission approved a monthly service rate of only \$36.50, but that rate resulted in an
4 operating margin of 17.98%. I would note that in the Daufuskie Island Utility rate case
5 now before the Commission, ORS has proposed that rates be adopted which result in an
6 operating margin of 15.22%.

7 In view of the undisputed \$80 Million in used and useful plant investments made
8 by Palmetto since its last rate case, which have created substantial new tax base, jobs, and
9 infrastructure for growth which will widen the customer base, its endeavors to create
10 economies of scale by a merger that benefits customers and serves administrative economy,
11 its willingness to phase-in the requested rate increase, its prompt and committed response
12 to the concerns of DHEC and others regarding the continued land application of effluent,
13 and its strong record of excellent customer service in comparison to other regulated
14 utilities, Palmetto believes that its operating margin should not be reduced as proposed by
15 ORS. Having said that, if any reduction is made, the operating margin should certainly be
16 no less than the high end of ORS's range, 15%, given Palmetto's excellent record and
17 standing among jurisdictional sewer utilities.

18 **Q. WHY DID PALMETTO SEEK APPROVAL OF RATES UNDER THE**
19 **OPERATING MARGIN METHODOLOGY AS OPPOSED TO RETURN ON**
20 **RATE BASE METHODOLOGY?**

21 A. Because our analysis of a case setting rates utilizing return on rate base at a return
22 on equity rate of 10% indicated that the proposed rate increase would be even higher than
23 that which we did propose. Palmetto has been sincere in its desire not to place too much

1 additional burden on customers at one time, which is why it was willing to consider a
2 phase-in of rates. I would note that our phase in proposal did not seek to impose carrying
3 charges on the foregone revenue, which is another indication of Palmetto's desire to be
4 sensitive to the impact on customers resulting from a \$80 Million investment which must
5 be recovered.

6 **Q. IS PALMETTO STILL WILLING TO PHASE IN A RATE INCREASE IN VIEW**
7 **OF THE ADJUSTMENTS PROPOSED BY ORS?**

8 A. No, it is not. With the adjustments proposed by ORS, and assuming an approved
9 rate resulting in the 15% operating margin at the top of ORS's recommended range,
10 Palmetto would realize an increase to only \$46.46 per month according to information
11 provided by ORS. This is a rate less than that approved for another regulated sewer utility
12 with less net utility plant in service and a rate far less than what the City of Columbia
13 currently charges non-resident customers. Such an increase would not cause rate shock to
14 customers and a phase in is therefore not warranted.

15 **Q. HAS ORS NOW RECEIVED FROM THE DEPARTMENT OF HEALTH AND**
16 **ENVIRONMENTAL CONTROL DOCUMENTATION OF THE FINAL**
17 **CERTIFICATIONS FOR OPERATION OF THE NEW PLANT AND FACILITIES**
18 **REFERENCED IN MR. MORGAN'S AND MR. SEAMAN-HUYNH'S**
19 **TESTIMONIES?**

20 A. Yes, it has received them and supplied them to ORS.

21 **Q. ARE YOU AWARE THAT ORS HAS MADE A FILING WITH THE**
22 **COMMISSION SUBSEQUENT TO SUBMITTING ITS DIRECT TESTIMONY IN**

THIS MATTER WHICH REFERENCES PALMETTO'S CORPORATE INCOME TAXES?

A. Yes, I am aware of ORS's filing of a petition with the Commission in Docket Number 2017-381-A in which it asserts that jurisdictional utilities, with some exceptions, should report the impact of the recently enacted reduction in federal income tax on their operations, make an estimate of that impact, and propose a procedure for changing rates to reflect that impact. The Petition does not, to my knowledge, state a date by which this report must be made. ORS further proposes in its petition that customers of these utilities should receive refunds for rates charged for services provided on or after January 1, 2018. ORS notes in its Petition that with respect to Palmetto and other jurisdictional utilities having pending rate cases, the impact of the new tax law can be considered in the proceedings related to that case.

Q. DO YOU HAVE ANY COMMENT UPON ORS'S PROPOSAL?

A. Yes, I do. Palmetto recognizes that this change in federal tax law may constitute a known and measurable change in its expenses which will require an adjustment. I do not at this time know what impact this will have in this proceeding as we have not yet had an opportunity to study and apply the new law to Palmetto's federal income tax liabilities. Palmetto reserves the right to comment on the adjustments that ORS intends to propose in this regard after the scope of that adjustment is known.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.